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C O N F I D E N T I A L SECTION 01 OF 03 VIENNA 000518

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TAGS: ENRG PREL EPET SENV PGOV AU
SUBJECT: U/S JEFFERY DISCUSSES ENERGY SECURITY WITH OMV AND
AUSTRIAN GOVERNMENT

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Classified By: Economic-Political Counselor Dean Yap for reasons 1.4
(b) and (d)

Summary

¶1. (C) During a March 27 meeting with U/S Jeffery, OMV CEO Wolfgang Ruttenstorfer pointed to Turkey as the critical piece for the Nabucco pipeline's success. Ruttenstorfer hopes that Turkey will sign an Intergovernmental Agreement (IGA), which EU Nabucco Coordinator is negotiating, by September or October. Without GoT approval of the IGA, Nabucco cannot move forward with an open season to offer non-binding capacity and the project could significantly stall, Ruttenstorfer warned. However, Ruttenstorfer opined that the threat of South Stream would motivate the GoT to be more cooperative on Nabucco. According to Ruttenstorfer, OMV was going very slow on its April 2007 Heads of Agreement with Iran to participate in the development of the South Pars gas field. Ruttenstorfer added that, in the long-run, Europe would need Iran's gas. Economics Minister Martin Bartenstein, in a separate meeting, clearly stated that Iranian gas was off-limits for Nabucco in the current political situation. Ruttenstorfer said that OMV would go ahead with oil exploration in northern Iraq, despite opposition from the Iraqi central government. Ruttenstorfer indicated that the Akkas gas field did not seem to be an option for Nabucco for now. Ruttenstorfer emphasized that the OMV-Gazprom joint venture for a gas trading platform did not allow the Russian company to gain control of any infrastructure at the critical Baumgarten gas hub. Ruttenstorfer and Bartenstein criticized the Commission's unbundling proposal, suggesting the Commission would have to find a compromise that fell short of full ownership unbundling.

¶2. (SBU) On climate change, MFA State Secretary Hans Winkler admitted Austria was well below its Kyoto emissions reduction target, claiming that transit traffic was the main culprit. Referring to the Commission's recent Energy and Climate Change Package, Minister Bartenstein said the GoA would oppose the auctioning of emissions certificates for energy intensive industries, unless the U.S. and China were "on board" with a post-Kyoto agreement. Bartenstein suggested global sectoral agreements might offer a good approach. As a last resort to prevent carbon leakage, the EU might consider a carbon duty, which "would be WTO consistent," on goods from countries that are not sufficiently contributing to emissions reductions targets. End Summary.

¶3. (U) During separate meetings on March 27, U/S Jeffery met with OMV CEO Wolfgang Ruttenstorfer, Austrian Minister of Economics Martin Bartenstein, and Austrian MFA State Secretary Hans Winkler. Discussions centered on energy

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security and climate change. Special Envoy to the EU C. Boyden Gray, EEB/ESC DAS Doug Hengel, Acting DCM, and EconUnit Chief accompanied U/S Jeffery.

Nabucco: Iran, Turkey, and South Stream

¶4. (C) Ruttenstorfer underscored that OMV was promoting alternatives to Russian gas through Nabucco and its planned LNG re-gasification facility in Krk, Croatia. Nabucco would look for gas "wherever we can get it," Ruttenstorfer said, including Azerbaijan, Central Asia, Iraq, and when the political situation improves, Iran. Ruttenstorfer stressed that, in the long-run, Europe would need Iranian gas and he noted that Nabucco was designed originally with Iranian gas in mind. Regarding OMV's April 2007 Heads of Agreement to participate in the development of Iran's South Pars gas field, Ruttenstorfer said that there was no final deal on the horizon. Minister Bartenstein said that Iranian gas remained "a no-go" for Nabucco because of the political situation.

¶5. (C) Turkey remained the most pressing challenge for Nabucco, according to Ruttenstorfer. The Turkish Government was reviewing a first draft of an Intergovernmental Agreement (IGA) among the five Nabucco partners. (Note: OMV previously told post that an IGA with Turkey is important because it would cover many issues included under EU law: third party access exemption; tariff methodology and parameters; protection of ownership; establishment of tax and levy regimes; and transit guarantees. End Note). EU Nabucco Coordinator van Aartsen has been charged with negotiating the IGA. It was critical to move forward with the IGA, as one of its addenda would establish a transit regime for Nabucco. Ruttenstorfer added that Nabucco needed to conclude the IGA

before it could initiate an open season to offer non-binding capacity on the pipeline. Ruttenstorfer said that he hoped Turkey would sign the IGA by September or October. Construction could then begin in late 2009 or early 2010.

¶6. (C) The threat of South Stream, according to Ruttenstorfer, had motivated Turkey to be more cooperative on Nabucco. OMV executives and Turkish Energy Minister Guler now meet every 3-4 weeks to discuss Nabucco issues. Ruttenstorfer quipped that "Turkey wanted to be Europe's gas supplier, although it did not have any gas." Regarding South Stream, Ruttenstorfer said it might make sense to combine it with Nabucco, but Nabucco was committed to including Romania, while South Stream was now committed to Serbia. Ruttenstorfer added that the big question was whether South Stream was real or simply a Russian ploy to try to torpedo Nabucco.

OMV Moving Forward with Oil Exploration in Iraq
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¶7. (C) Iraq, according to Ruttenstorfer, remained a potential supplier to Nabucco in the medium-term, as its gas reserves have never been developed. Ruttenstorfer noted that OMV had signed two oil production sharing agreements (ref B) with the Kurdish Regional Government. The Iraqi Central Government reacted by imposing an oil embargo on OMV (ref A), but Ruttenstorfer maintained that the agreements were in line with the Iraqi constitution. Ruttenstorfer added that uncertainties surrounding the Akkas gas field meant it was not an option for Nabucco at this time.

USG Opposes Investment in Iran's Energy Sector
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¶8. (C) U/S Jeffery offered USG assistance, where requested,

to try to unblock impediments to Nabucco, e.g., encouraging Turkey to agree to a reasonable transit regime. On Iran, U/S Jeffery stressed that the USG strongly opposed any investment in Iran's energy sector, such as the recent deal concluded between Iran and Switzerland's EGL. U/S Jeffery underscored that it was important for Iraq to have a solid legal framework in place on the federal level to allow investments in the energy sector to move forward with certainty.

Baumgarten Gas Trading Platform

¶9. (C) Ruttenstorfer stressed that the Central European Gas Hub (CEGH) joint venture between OMV and Gazprom was a computer-based gas trading platform, facilitating over-the-counter trading among approximately 15 traders. The Euro 2 million CEGH did not allow Gazprom to control any of the physical infrastructure at the Baumgarten gas hub.

¶10. (C) OMV hopes to build the CEGH up to be one of the biggest gas trading platforms in Europe. To do this, Ruttenstorfer stressed, the CEGH needed to increase liquidity at the Baumgarten hub. As the principal supplier to the hub, Gazprom was the only partner that could provide sufficient liquidity. "Virtual gas does not exist," Ruttenstorfer said, adding that OMV was increasing its current level of storage from 5 bcm to 8-9 bcm, equal to Austria's annual consumption.

European Oil Market Consolidating

¶11. (C) The European oil market, according to Ruttenstorfer, functioned well based on free market principles and a clear regulatory framework. Companies from Russia and other CIS countries were expanding westwards, but Ruttenstorfer maintained that this was "natural." However, Ruttenstorfer said that, as more European refineries are sold to sovereign wealth equity funds, there is a possibility that the funds could then sell the refineries to Russian interests. Ruttenstorfer predicted that consolidation would eventually yield 1-2 oil companies "plus the Russians" in the Central European market. With this in mind, Ruttenstorfer noted that OMV would continue to pursue a takeover of Hungary's MOL to strengthen its position in the market.

Gas Sector: Austria Opposes Unbundling

¶12. (C) Europe's gas sector, according to Ruttenstorfer, was more problematic. The Commission's 3rd Energy Package was an

attempt to address some shortcomings, but the approach was faulted, Ruttenstorfer maintained. OMV opposed the Commission's proposals, particularly the legal unbundling of gas generation and transmission. Unbundling would, in Ruttenstorfer's view, not improve Europe's energy security, because it would discourage large infrastructure projects. The Commission should instead insist on full implementation of existing regulations.

¶13. (C) Minister Bartenstein reiterated that the GoA remained opposed to full ownership unbundling. Bartenstein opined that there would eventually be a compromise between the Commission's proposals and "the third way" espoused by a blocking minority of Member States. Bartenstein maintained that the decision by Germany's E.ON to sell its electricity transmission grid was a quid pro quo for DG Comp's agreement to terminate an anti-trust investigation against E.ON in the electricity sector.

Climate Change and Carbon Leakage

¶14. (SBU) MFA State Secretary Winkler admitted that Austria was struggling to meet its Kyoto targets to reduce CO_2 emissions (Note: According to the Austrian Environmental Agency, in 2005 Austria was 35.6% above its target to reduce its CO_2 emissions by 13% based on 1990 figures. End Note.) Winkler singled out emissions from transportation, particularly transit traffic between Italy and Germany, as the major culprit. Although renewables already represented a relatively high portion of Austria's energy mix (23%), the Commission was now asking Austria to raise this further to 34% by 2020 (Note: The GoA has criticized the Commission's target as too ambitious, but the GoA's 2007 government program set a target of 45%. End Note).

¶15. (SBU) Minister Bartenstein acknowledged that there would be difficult negotiations within the EU to establish new burden sharing arrangements to reduce emissions. In Bartenstein's opinion, the Commission should not force energy intensive industries, such as steel, cement, and maybe automobile, to buy emission certificates via an auction, if the U.S. and China are not "on board" with a post-Kyoto agreement. An alternative, in Bartenstein's view, might be global sectoral agreements in the energy intensive industries. The least preferable solution, according to Bartenstein, would be an EU import duty, "which would be consistent with WTO rules," on goods from non-contributing countries.

¶16. (SBU) Special Envoy Gray noted that Europe continued to underestimate U.S. action to combat climate change. The U.S. was spending billions of dollars on environmental technology, such as biofuels and clean coal technology. The USG and Europe should stand united in dealing with emerging economies, which need to contribute their fair share to reduce global emissions. The Major Economies Meetings (MEM) format, Special Envoy Gray stressed, was a mechanism to bring China and other emerging economies into the negotiating process. Special Envoy Gray said the MEM's goal was to craft a strong roadmap at the G-8 Summit in Japan this summer to support the UNFCCC process. He underlined that it was important to achieve progress now, particularly given that there will be political transitions in Brussels and Washington in 2009, which may temporarily slow down momentum.

¶17. (U) U/S Jeffery and Special Envoy Gray have cleared this message.
Kilner